



State Investment Commission
Monthly Meeting Minutes
Wednesday, January 27, 2016
9:00 a.m.
Room 205, State House

The Monthly Meeting of the State Investment Commission (SIC) was called to order at 9:08 a.m., Wednesday, January 27, 2016 in Room 205, State House.

I. Roll Call of Members

The following members were present: Mr. J. Michael Costello, Ms. Faith LaSalle, Ms. Paula McNamara, Mr. Mark Dingley as designee of the Dept. of Administration in the absence of Mr. Tom Mullaney, Ms. Marcia Reback and Treasurer Seth Magaziner. Mr. Frank Karpinski arrived at 9:10am.

Also in attendance: Mr. Thomas Lynch of Cliffwater, alternative investment consultant; Mr. John Burns, and Mr. Allan Emkin of Pension Consulting Alliance (PCA), general consultant; Ms. Susan DeBlasio of Adler Pollock & Sheehan P.C., legal counsel; Mr. David Iden and Mr. Matt DiCrocce of TIAA-CREF; Mr. Roland Reynolds of Industry Ventures; Mr. Michael Green and Mr. Stephens Johnson of Tenex Capital Management; Ms. Tiffany Spudich of Capital Cities; Mr. David Malone and Mr. Chris Reimer of Ascensus College Savings; Mr. Duy Nyugen and Mr. Brian Thorpe of Invesco; Ms. Anne-Marie Fink, Chief Investment Officer and members of the Treasurer's office staff.

Mr. Thomas Fay, Mr. Tom Mullaney Mr. Robert Benson and Ms. Marie Langlois were absent. Treasurer Magaziner called the meeting to order at 9:08 a.m.

II. Approval of Minutes

On a motion by Ms. Reback and seconded by Ms. LaSalle, it was unanimously

VOTED: to approve the draft of the minutes of the December 16, 2015 meeting of the State Investment Commission.

III. TIAA-CREF Quarterly Performance Review

Mr. Iden introduced himself and Mr. DiCrocce, and provided an overview of the assets within the defined contribution plans. As of December 31, 2015 the plans had \$447 million in assets. He also detailed TIAA-CREF's participant engagement efforts in the fourth quarter of 2015 and noted that TIAA-CREF has been coordinating with ERSRI to increase engagement opportunities with participants in the defined contribution plans.

Mr. DiCrocce summarized the fourth-quarter investment performance for the Commission. He reviewed the returns for each offering in the plans. Treasurer Magaziner asked about the portfolio construction and performance of the Social Choice fund. Mr. DiCrocce explained that the Social Choice fund is not strictly free of fossil-fuel companies; he stated that other fund underweights, particularly of some technology stocks, contributed to its underperformance relative to the broad Russell 3000 index. Mr. DeCrocce also noted that the menu's best performer has been the real estate account. He said all returns fall in line with their relative benchmarks.

Beyond performance, Mr. DiCrocce also highlighted a reduction in fees, falling from 11 basis points to 8 basis points, that asset manager Vanguard implemented as of January 1st.

IV. Industry Ventures Partnership Holdings Fund IV Recommendation

Mr. Thomas Lynch of Cliffwater introduced Mr. Roland Reynolds of Industry Ventures and reminded members that the Commission invested in Industry Ventures' prior fund, Partnership Holdings Fund III. Mr. Reynolds described his firm, investor base, and fund strategy. He explained that a majority of the firm's investors are pension funds. The firm seeks to build a diversified portfolio of primary and secondary stakes in early- and mid-stage venture capital funds, as well as co-investments alongside these venture funds. Fund IV's hybrid structure supports the firm's strategy of providing quicker returns to investors than other approaches to venture investing. Treasurer Magaziner asked about the firm's ability to deploy investor funds effectively. Mr. Reynolds explained that Industry Ventures has succeeded in effectively putting investor funds to work, and referenced an example from the last fund. Mr. Costello asked about the distribution activity from Partnership Holdings Fund II. Mr. Reynolds noted that Fund II is ahead of schedule and that the firm expects an acceleration in distributions to investors. Mr. Reynolds highlighted the success of Partnership Holdings Fund III.

Mr. Costello asked for details on the size of Fund IV in comparison to Fund III. Mr. Reynolds explained that Fund III was roughly \$200 million, and the goal is for Fund IV to replicate the size and structure of that previous fund. Mr. Costello asked Mr. Lynch about the recommended size of investment. Mr. Lynch said that Cliffwater is recommending a \$10 million investment in Fund IV. Additionally, a transfer of the \$13 million overage fund commitment that was intended to invest alongside Fund III to a commitment to invest alongside Fund IV would bring ERSRI's total exposure to Fund IV investments to \$23 million. Treasurer Magaziner asked Mr. Reynolds for his opinion on the current status of the venture capital industry. Mr. Reynolds said that he is confident that Industry Ventures is positioned well to succeed in the current market environment.

On a motion by Ms. Reback and seconded by Mr. Costello, it was unanimously

VOTED: to approve a \$10 million commitment to Industry Ventures Partnership Holdings Fund IV and a modification of Industry Ventures Partnership Holdings Fund III-C to allow investments alongside Industry Ventures Partnership Holdings Fund IV – subject to successful negotiations with the fund.

V. Tenex Capital Management Fund II Recommendation

Mr. Lynch introduced Mr. Michael Green and Mr. Stephens Johnson of Tenex Capital Management. Mr. Lynch noted that Tenex seeks to generate value by investing in mature, underperforming companies. Mr. Green explained that the strategy of Tenex is to utilize operational leverage to increase company efficiency. Tenex focuses on middle-market industrial companies in the United States and Canada. Mr. Green said that Tenex seeks companies with inefficient operations and underutilized assets, with the goal of returning them to industry-average performance. He told the Commission that the three founding members of Tenex have been partners for over ten years and are all former engineers from General Electric. Mr. Green noted that this background in operational efficiency is beneficial to the firm's strategy. He described Tenex as a situational investor, pursuing the opportunities made available. Mr. Green highlighted the success of Tenex Capital Management Fund I.

Mr. Costello asked if Tenex was approached by companies looking to be bought, or if the firm sought out opportunities. Mr. Green explained that a majority of deals are marketed and that the pipeline of potential companies is robust. Mr. Lynch said that Cliffwater recommends an investment of up to \$30 million. He noted that Tenex has a demonstrated track record of generating substantial value after acquiring portfolio companies. Mr. Costello asked if Tenex held a unique role in private equity and if there was strong competition. Mr. Lynch explained that the firm's strategy to transform companies' operations using lean manufacturing techniques, combined with Tenex leadership's previous experience, is differentiated.

On a motion by Mr. Costello and seconded by Ms. Reback, it was unanimously

VOTED: to approve a commitment of up to \$30,000,000, subject to legal review and availability, to Tenex Capital Management Fund II.

VI. Calendar Year-End Hedge Fund Portfolio Review

Mr. Lynch provided an overview of the equity and absolute-return hedge funds. He described the performance, net of fees, of these portfolios compared to benchmarks. Mr. Lynch noted that the equity hedge fund and absolute-return hedge fund portfolios outperformed their respective benchmarks, while also maintaining less risk. He explained that Luxor Capital has been placed on Cliffwater's watchlist following recent underperformance.

Ms. Reback asked about the cause of Luxor's watchlist status. Mr. Lynch explained that the fund's 2015 underperformance was due to poor securities selection and that Cliffwater would continue to review Luxor's performance. Treasurer Magaziner asked Mr. Lynch to comment on the role of hedge funds in the portfolio generally. Mr. Lynch explained that given market conditions in 2015, the hedge funds served their role in the portfolio successfully.

VII. CollegeBoundfund Investment Menu Recommendation

Ms. Fink provided an overview of the upcoming 529 plan investment line-up selection process. She introduced Mr. Brian Thorpe and Mr. Duy Nyugen of Invesco, and Ms. Tiffany Spudich of Capital Cities. Ms. Spudich explained that representatives from AllianceBernstein, Invesco, Ascensus and the Treasurer's Office have been in regular contact to design the proposed investment line-up. Due diligence efforts included contacting advisors to listen to their input and solicit feedback. Invesco and Ascensus revisited their proposed investment menu following their selection as program manager in November. Ms. Spudich explained that the new proposed menu reduces investment expenses across the board. The design process was collaborative and Capital Cities believes that the proposed investment menu will distinguish the Rhode Island plan from others nationally.

Mr. Thorpe noted that the proposed menu has reduced the number of age-based glidepaths from the current four tracks to one. He explained Morningstar's 529-plan rating system and how the current proposal successfully addresses all core Morningstar considerations. Mr. Thorpe noted that incorporating advisor feedback was a focus. He added that there was a positive reaction from advisors that Invesco would be returning to the 529 marketplace. Mr. Thorpe concluded by highlighting features of the advisor and direct plans.

Mr. Nyugen introduced two key points that guided the design of the proposed investment menu. First, he explained that the age-based glidepaths have been optimized to better fit the current 529 market. Additionally, Invesco has proposed quarterly rebalancing of assets instead of the more typical annual occurrence. Mr. Costello asked how investments are handled once a child reaches college age. Mr. Nyugen explained that Invesco has designed a terminal glidepath option focused on liquid investments that accommodate any distribution timeline (two, four or more years). Ms. McNamara asked what the process would be for residual assets remaining after all required distributions are completed. Mr. Thorpe said that accounts could be transferred to a new beneficiary, withdrawn or left in place. Mr. Nyugen introduced some of the features of the advisor-sold plan. He explained that the proposed menu includes enough options to fully support advisors without superfluous choices.

Treasurer Magaziner noted that the direct plan does not have an active equity option but those are available in the advisor plan. Mr. Reimer of Ascensus confirmed that observation, stating the goal of direct, do-it-yourself plan was to keep costs low; this approach is in line with industry best practices. Treasurer Magaziner asked for an overview of the costs of the direct plan. Ms. Spudich explained that the average cost within the current individual direct plan is 0.52 percent (52 basis points) and the proposed menu would reduce that figure to only 0.14 percent (14 basis points). Costs within the age-based portfolios are currently

0.19 percent (19 basis points) and would be lowered to 0.10 percent (10 basis points) within the proposed menu. The fixed allocation portfolio currently costs 0.82 percent (82 basis points) and would be lowered to 0.16 percent (160 basis points). Ms. McNamara asked if there was a process for eliminating or replacing underperforming funds. Mr. Nyugen said Invesco has internal mechanisms in place and would collaborate with the Treasurer's Office to address such funds. Mr. David Malone of Ascensus noted that his firm would also monitor and suggest changes to underperforming funds.

On a motion by Ms. LaSalle and seconded by Ms. Reback, it was unanimously

VOTED: to approve the proposed 529 CollegeBoundfund Advisor-Sold Investment Menu.

On a motion by Mr. Costello and seconded by Ms. Reback, it was unanimously

VOTED: to approve the proposed 529 CollegeBoundfund Direct-Sold Investment Menu.

VIII. Investment Policy Statement for Hedge Funds & Private Equity

Ms. Fink reminded members that the current hedge fund and private equity investment policy statements would be the final segments of the comprehensive investment policy they have been working on for the last year or so. The hedge fund and private equity drafts were provided at the previous month's meeting. Ms. Fink asked if the members had any questions about the proposed investment policy statements. There were no questions.

On a motion by Ms. McNamara and seconded by Ms. LaSalle, it was unanimously

VOTED: to approve the Investment Policy Statements for Equity Hedge Funds, Absolute-Return Hedge Funds, and Private Equity.

IX. Legal Counsel Report

There was no legal counsel report.

X. Chief Investment Officer Report

Ms. Fink reviewed the performance of the portfolio for December. The portfolio was down 1.15% for the month. This compared to -1.2% for the 60/40 allocation and the bottom-up benchmark. She noted that December was a difficult month for equities and that hedge funds and private equity were the portfolio's better performers. The MLP allocation remained challenged as a result of energy market turbulence. The Quality-Value-Momentum (QVM) factor-tilt portfolio performed well, down 1.5% compared to the relative index being -1.8%. Looking at performance since inception, this factor portfolio has outperformed. She said that on a fiscal-year-to-date basis, the overall portfolio was down 2.8%. The second half of 2015 was challenging for equity markets and MLPs were particularly negative. She highlighted the lower risk of the portfolio compared to the 60/40 and the portfolio benchmark. She noted that energy has been a large source of market losses over the past eighteen months, with the price of a barrel of oil dropping from over \$100 to under \$30 over that time. MLPs, infrastructure and private equity are areas within the portfolio where energy fluctuations have had the most impact.

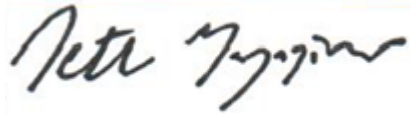
Ms. Fink provided an update on the Proxy Advisor RFP process. She thanked Ms. McNamara for assisting on the subcommittee and that the Commission could anticipate a recommendation at the February meeting. She also introduced Ms. Lisa Churchville and Ms. Kimberly Shockley, the new Director and Associate Director of Participant-Directed Programs. Their roles will focus on the defined contribution, deferred compensation and 529 plans.

XI. Treasurer's General Comments

Treasurer Magaziner stated that portfolio diversification was a positive during the previous calendar year. 2015 was one of the most challenging years since the financial crisis, with global equity markets down 2.5%. Diversification limited portfolio losses to only 0.25%. Treasurer Magaziner thanked Commission members for their commitment and thoughtful participation over the past year.

There being no other business to come before the Board, on a motion by Mr. Costello and seconded by Ms. McNamara the meeting adjourned at 11:58 a.m.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Seth Magaziner", is centered on the page. The signature is fluid and cursive.

**Seth Magaziner,
General Treasurer**